WestJet Airlines (TSX:WJA): Worth the Risk?

Description

WestJet Airlines (TSX:WJA) is becoming an extremely unique airline, and by extension, investment.

Airlines will typically attempt to tackle the side of the market that poses the greatest opportunity. For some airlines, that could mean establishing a solid foundation of trans-Atlantic routes that expose the airline to lucrative business class fares and freight opportunities, whereas for other airlines, establishing a strong domestic network of routes at a competitive rate can yield its own success.

When it comes to WestJet however, the company is trying to cater to both ends of the market, and despite the obvious risk, there is a lucrative investment opportunity within that strategy.

On the one hand, WestJet's now established international service is attracting more customers than ever before, thanks both to the airlines larger network and the fact that WestJet no longer needs to hand off customers to another carrier for international travel; those connecting passengers can now stay on WestJet's network. Adding to that appeal is the fact that international routes are serviced by larger aircraft, fielding more passengers and freight than the smaller domestic routes could ever carry.

Finally, there's the introduction of premium service. WestJet has always been regarded as a discount carrier, but with the rollout of WestJet's new 787 Dreamliner fleet, the company is introducing a premium class for passengers that features expanded meal service, and larger seats that fully recline into flat-beds. The concept must be proving successful. as WestJet saw premium fares witness a whopping 70% increase year-over-year in the most recent quarter.

On the other hand, WestJet's venture into the bottom end of the market, specifically launching its ULCC, Swoop also has potential. ULCCs typically offer bare-bones pricing and few amenities to passengers, allowing them to buy whatever items or preferences they desire onboard. Part of that low-price structure also calls for the carrier to operate out of second-tier airports where fees are lower, such as flying out of Hamilton instead of Toronto, or Abbotsford instead of Vancouver.

Both initiatives have so far proven successful for WestJet as represented in the most recent quarterly update.

Fourth-quarter results

Earlier this month WestJet provided an update on the fourth fiscal of 2018, which saw the company post total revenue of $1,193.3 million, thereby reflecting a 6.6% increase over the same quarter last year. Much of that gain could be attributed to a larger capacity and greater traffic, both of which saw noted improvements over the prior year by 5.9% and 4.5%, respectively.

Despite the gain in revenue, WestJet's earnings came in lower during the fourth quarter, with the company posting $29.1 million, or $0.26 per diluted share, reflecting a noted decline over the $45.8 million, or $0.40 per diluted share reported in the same period last year. Much of that drop was attributed to higher costs across the board, such as rising fuel prices and costs associated with the rollout of Swoop. Costs related to WestJet's new 787 Dreamliners are expected to appear within the next few quarters, hitting $500 million in fiscal 2019.

Finally, unlike many of its peer airlines, WestJet offers an attractive quarterly dividend that currently provides a yield of 2.67%. Investors should view that dividend as icing on the cake rather than as a primary reason to invest in the stock, as WestJet last bumped its dividend back in 2014. Income-seeking investors would be better served looking elsewhere.

Bottom line

There's no denying that WestJet and indeed the entire industry will experience headwinds in the future. That said, looking at a more macro level, there are a number of encouraging signs that investors should take note of when it comes to reviewing WestJet. Revenue, available seat miles, and the number of segment guests all saw handsome gains throughout 2018, and the airline's load factor topped its highest level in the previous five-year period.

Additionally, WestJet's 2019 guidance is forecasting respectable growth numbers for the next fiscal despite the substantial capital expenditures relating to the new Boeing MAX and 787 Dreamliner aircraft that the company is purchasing and factoring in as much as a 7 % increase in fuel charges over the prior year.

In short, WestJet remains an intriguing investment option for those looking to diversify their portfolio.

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